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SUBJECT: SOUTH KOREA TO IMPORT RUSSIAN GAS THROUGH NORTH KOREA

REF: VLADIVOSTOK 094

Summary

1. Gazprom and Korean Gas Corporation signed a letter of understanding outlining a thirty-year, USD 90 billion deal to bring Russian natural gas to the Republic of Korea via a pipeline through North Korea. Construction of the pipeline is scheduled to begin in 2011 for completion in 2015. North Korea has yet to participate in talks on the deal.

First, the Easy Part

2. Gazprom and state-owned Korean Gas Corporation (Kogas) have signed a letter of understanding that will have Russia exporting USD 90 billion worth of natural gas to South Korea annually for thirty years. The 10 billion cubic meters per year will amount to approximately 20 percent of South Korea's overall demand. The deal was announced following a September 29 meeting between President Medvedev and South Korean President Lee Myung-bak in Moscow. The companies will sign the final agreement for the deal in 2010 after a feasibility study is complete, and gas shipments will begin in 2015.

Figuring Out the Tough Parts Later

3. To transport the gas, the companies have agreed to construct a natural gas pipeline from Vladivostok to South Korea through North Korea. Construction for the proposed USD 3 billion project would begin in 2011, with gas flow beginning in 2015. North Korea, however, has not yet taken part in talks regarding the deal. According to a Consulate contact, it was Russia who initially proposed the plan and will be in charge of convincing North Korea to take the deal.

4. In return, North Korea will collect USD 100-150 million in transit fees annually for the duration of the contract. Consulate contact suggested that Pyongyang will also reap financial benefit by providing most of the labor for the Russian and North Korean segments of the pipeline. [Note: North Korean workers in the Russian Far East are a significant revenue stream for Pyongyang, which provides the manpower through virtual indentured servitude and pockets most of the salaries. End Note.]

The Backup Plan

5. If Pyongyang declines the financial incentives and refuses to approve the pipeline plan, the deal for the gas itself will still stand. Russia and Korea announced plans to jointly construct a liquefied natural gas facility near Vladivostok and develop port facilities outside of Slavyanka. This construction

would be undertaken concurrently with the pipeline project and would allow gas transport to South Korea by ship, an alternative route that would add about 30 percent to the overall cost of the gas.

¶6. Presidents Medvedev and Lee also announced agreements to jointly develop oil and gas off the West coast of Kamchatka, connect the Trans-Korean railroad with the Trans-Siberian, and develop a chemical plant outside Vladivostok.

Comment

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¶7. The deal will help both countries realize plans to diversify trade in natural gas. Russia has been looking for an alternative to the European market, and Korea wishes to reduce its dependence on gas from the Middle East, which currently provides 90 percent of the country's demand. North Korea did agree in April to a joint project with Russia to renovate its rail links connecting the two countries, though that deal did not include connections with the South (reftel), so an agreement may be possible. However, considering that the construction of the pipeline will not begin for several more years, and that the North Korean leader is in poor health, it is also possible that both parties are assuming that Pyongyang will be irrelevant when the time comes to begin construction.

BENJAMIN